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Upholding Europe's mandate on trade

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Summary

This paper concerns Europe's ability to continue its trade strategy into large scale FTAs that are necessary to sustain EU industrial capacities. The first challenge for Europe is the EU-Japan FTA, whose merits have been met with scepticism due to Japan's lack of openness. Such notions are misguided. First, they fail to take into account that the US exports are outperforming the EU on the Japanese market – it is simply unlikely that Japanese trade barriers are designed to promote US and Chinese firms while discriminating against the EU. Second, as Japan is likely to conclude (and perhaps prioritise) other trade agreements besides an FTA with a declining Europe, the EU-Japan FTA is necessary to maintain European market shares in the world's second largest consumer market against the global competition.

In this regard, the recent East Asia Summit saw the opening of negotiations for RCEP (ASEAN +6) and the relaunch of the three party FTA negotiations between China, Japan and Korea (CJK). Public support in Japan for joining the TPP has now reached a critical mass. Each of these three RTAs creates a trade diversion that wipes out any GDP gains that EU could achieve through its FTAs, including the EU-US FTA. Furthermore, Japan is the only strategic partner in the Asia Pacific region with similar values that could engage and influence China economically and politically; Japan is also the second largest shareholder of the IMF that holds the political future of some Eurozone governments.

Meanwhile, the debate on the negotiation mandate has been marked by an unprecedented lack of confidence for the Common Commercial Policy that undermines the EU's credibility and leverage in EU-US talks and other future FTA negotiations. Moreover, protectionist concerns for the European car industry (which is now running a trade surplus against Japan) have been allowed to block the proceedings although mercantilism is counterproductive to the long-term goals of the EU – as it legitimises similar behaviour by the other major economies.

1. Introduction[1]

This paper concerns Europe, her ability to pursue large-scale FTAs, the reforms that such endeavours will entail and the opposition they face. Previous ECIPE publications have dealt with the difficulties of the EU in its race towards next-generation FTAs.[2] Agreements with Korea and the Andean Community have since been concluded, while negotiations with Canada and Singapore seem close to completion. The analysis has highlighted their merits, while having no illusions about their contribution to European GDP – as their share of EU external trade or global GDP is merely 5%, while the export increases they generate fall within the margins of error of EU GDP estimates. This is not because of the quality of the agreements, but due to the vast difference in size. Moreover, none of the past FTAs were able to mount any serious pressure to reform the Single Market. Such 'FTA induced' reforms at home would have the biggest impact on growth and prosperity for the EU that is in need of improved competitiveness and restructuring. Yet reforms are understandably difficult in a time of fiscal austerity, even with the carrots provided by foreign trade.

This current state of play called for a rethink of the *Global Europe* strategy and its bilateral FTAs, with a consensus that Europe needed to put further emphasis on 'big FTAs'.[3] In practice, only three bilateral agreements could have a significant impact on the EU economy overall – these are the US, China and Japan. They have an economic output exceeding 5 trillion USD, equivalent to at least one-third of the EU GDP. Whereas countries next in rank (e.g. Brazil and Russia), immediately drop to one-sixth of EU GDP. On this account, the High-Level Working Group on Growth and Jobs has weighted different approaches for a possible EU-US co-operation with varying degrees of progress and enthusiasm. While going West has proved to be more difficult than Brussels may have anticipated, there were certainly no illusions about turning East. Although the outgoing Chinese leadership seems to have concluded that a grand bargain through an FTA is now inevitable if the issues in the EU-China relationship are to be resolved,[4] there remain some deep-rooted ideological collision in this political climate that make a reciprocal interest from the EU implausible in the short term, and mercantilism prevails on both sides in that stand-off. This turns the focus to the first amongst Europe's 'big FTAs' in the works – namely Japan.

2. European prospects on the Japanese market

The European countries face a different challenge when it moves towards negotiations with counterparts are on an equal footing with the EU. To date, the EU and US FTAs have been based on a 'model FTA', developed from their respective FTA with Korea that made far-reaching concessions to reform its economy despite few reciprocal gains besides on tariffs. It is geared towards opening up much smaller economies (Korea's GDP is one-twelfth of the EU's) or countries with a history of inconsistent regulatory quality – and it is not surprising that best practices developed out of them in the EU/US High Level Working Group have produced inconsequential results; nor do they have little meaning towards the two giants in the East, whose economies or relations with the EU have little or no commonalities with Korea.

China and Japan are of similar sizes, each accounting for 8-9% of global GDP which is five to six times larger than Korea. While the market potential of China's inner demand (and the barriers shielding it) is a topic of much discussion in recent years, less is said about Japan. Given the much higher levels of consumption in Japan, which is twice that of China's, the

[1] This paper is based on a speech delivered at the Delegation of European Union in Tokyo on November 13th, 2012. The author wishes to thank the Delegation and the Member States representatives for their kind invitation and engaging discussions.

[2] See Lee-Makiyama, 2011; Erixon, Lee-Makiyama, 2010

[3] European Commission, DG Trade, Trade Policy Communication, 2010

[4] Remarks by Wen Jiabao at EU-China Summit 2012

potential target market for exports should be the size of China's. But theories differ from reality. On the bottom line, imports have only 6% of Japan's massive consumption, quite modest compared to 15.6% for the EU.[5] At first sight, it seems to suggest that Japan is more closed than China and that the EU is the most open economy of all four large economies. However, such simplifications are often misleading.

Table 1: Consumption and imports
Comparison between European target markets

	Japan	China	US
GDP (USD)	5.9 trillion	7.3 trillion	15.0 trillion
Final consumption (share of GDP)	**79%**	**47%**	88%
Household consumption (share of GDP)	59%	34%	71%
Intermediate consumption in production (share of GDP)	45%	n/a	43%
Merchandise trade (share of GDP)	29%	25%	50%
Import penetration (share of total demand incl. capital formation, re-exports)	**6%**	**9%**	8%

Source: IMF; World Bank; OECD STAN; Own calculations

To begin, the import figures between China and Japan are not directly comparable. Most of China's imports (more than 75%) are input goods of components and intermediate goods destined for its processing trade.[6] In reality, very little of the 9% actually stays inside China but is re-exported again at a small premium, leading to an actual share that is less than 4%. This also explains the EU's unbalanced trade with China: At the current stage of China's development and income levels, there is a strong demand for German components and machinery that accounts for half of EU exports,[7] while the demand for other goods is so far negligible.

However, this only explains how China imports even less, and gives little explanation to the conditions in Japan. First, developed economies such as Japan or the US are far more mature and competitive. Imports face greater competition from well-established domestic producers. This is a fact of life, and a well-documented one in the case of Japan: Businesses complaining about 'too much competition' in Japan are not unheard of, or that even local competitors have meagre profit margins that do not justify the high costs of entering the Japanese market. This leads to a second possibility, that overregulation, regulatory divergences or trade barriers seriously impede on the trade with Japan, as evident from its low trade dependency.

But perhaps the key reason why Japan imports so little is because its trade with the EU have gone missing – the EU holds a significantly lower share of Japan's imports compared to its share of global trade, underperforming against other developed economies. If the EU could have maintained its market share relative to the US on goods alone, the import penetration in Japan would increase by at least one percentage point and similar to US levels.

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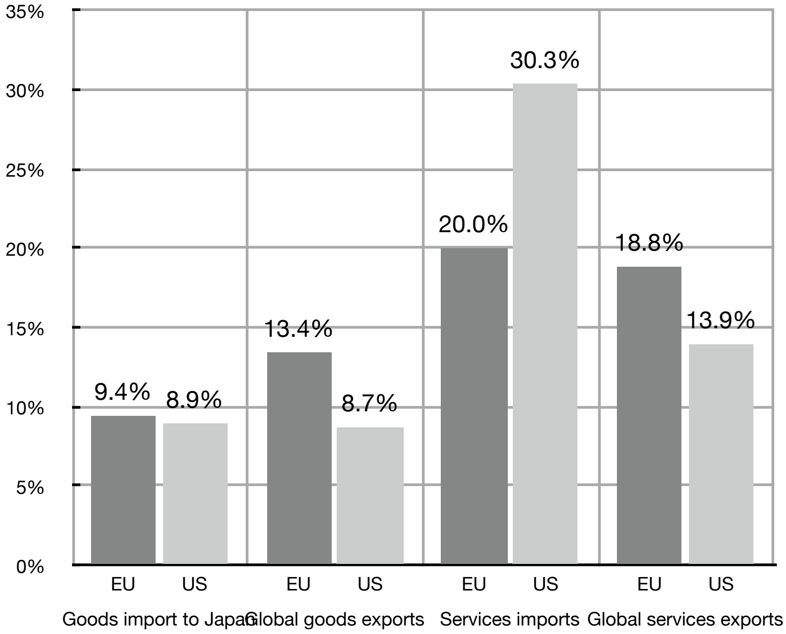
[5] Based on intermediate and final consumption expenditures, gross capital formation and re-exports
[6] UN BEC, 2011
[7] UN Comtrade, 2011

Table 2: EU/US share of imports into Japan compared to their share of global trade



Source: UN Comtrade 2011; Japan Ministry of Finance, 2012

In the past 15 years, Japan diversified its supply-chains towards its Asian neighbours, making the US upper hand on the Japanese market less pronounced. Still, US exporters still outperform the European competition with ease. This is particularly prominent in key EU export sectors in manufacturing, such as pharmaceuticals, machinery, aerospace. Ironically, the only sector where the EU outperforms the US with a considerable margin is cars, where the protectionist instincts in crisis-struck European countries risks blocking further progress. Moreover, the EU share of services may be in level with its global export share of around 20% – but the US exports 50% more than the EU, although the EU exports 35% more than the US globally.[8]

Table 3: US dominance over the EU on the Japanese market
Comparison of US & EU export competitiveness in Japan

Total goods trade	1.5 times EU competitiveness
Organic chemicals	0.8
Pharmaceuticals	1.3
Machinery	1.5
Motor Vehicles	0.3
Aerospace	25.0

Source: Own calculations;[9] based on data from UN Comtrade 2011

[8] Japan Ministry of Finance, Extended Balance of Payments, 2011
[9] The figure represent the ratio between US/EU revealed comparative advantage (RCA)

But why is the EU losing out to the US on the Japanese market? Anomalies of this scale cannot be explained by the close strategic ties between the US and Japan – with the possible exception of the heavily politicised aerospace and defence industry.[10] It is also unlikely that the local trade barriers in Japan benefit US imports while discriminating against goods from the EU. Are US goods and services better suited for Japanese market and other highly developed economies? If so, industrial restructuring of a disturbingly large proportion awaits the EU's export sectors as global demand continues to pivot towards Asia; that would also suggest that there are limited export gains for the EU in an EU-US FTA as the supposedly more efficient US exporters would quash the EU competition.

Such conclusions simply cannot hold true. If we assume instead that EU products, technology and services are still competitive, then their absence in Japan can only be explained by firm-level decisions to focus their presence elsewhere – after all, the EU surpasses the US in other Asian markets, most notably in China and Korea. Under these circumstances, the mercantilist's handbook would prescribe that the EU should seek a preferential agreement with Japan in order to bring the EU back to normal levels vis-à-vis US competition. But the US is also seeking its own preferential access to the Japanese market. The EU-Japan FTA is not so much about catching up with the US competition, but an existential question about maintaining the EU's frail position in Japan.

3. Regional integration and its impact on the EU

The imperative of levelling the playing field against the competition from other developed economies in Japan, world's second largest consumer market, may seem obvious. However, EU trade policy does not exist in a vacuum: Macroeconomic shifts, or new trade deals bring about reactions from others who seek to parry the initiative, or take advantage of our inaction. Even our current FTAs were largely policy responses necessary to counter the intra-Asian integration and US FTAs that give them first-mover advantages in the emerging markets.

This current web of relatively light FTAs is now evolving into a new regional architecture, consolidating with existing regional agreements or investment links. Whether it is due to market attractiveness, geographic centrality or strategic importance, Japan is currently the only country that is invited to all three proposed RTAs in the Asia-Pacific region, whether they are championed by China, ASEAN, the US or Japan itself – the Trans-Pacific Partnership (TPP), the three-party FTA between China, Japan and Korea (CJK) or the long-term prospects of an Asian free trade area through RCEP (Regional Comprehensive Economic Partnership or ASEAN+6). Whether these three agreements will actually materialise in the short or long term, the EU has so far only opened up negotiations with less than 15% of the combined GDP of the TPP candidates,[11] leaving out major markets like Japan and Australia.

The prevailing view in Brussels is that the TPP proponents grossly underestimate the difficulties involved in harmonising their existing FTAs into an RTA.[12] This view is not without merit. However, Brussels also underestimates the political capital that has been invested into the completion of the TPP, particularly in Washington DC where it remains the indisputable and bipartisan first priority of trade and foreign policy – and so far, the EU response has been one of caution, inertia or simply to cross fingers that the TPP may fail.

But such inaction is also costly – as noted in the previous section, the EU-Japan FTA is primarily about restoring or maintaining EU market shares against US competition. Quantitative studies shows that the trade diversion from TPP or CJK would eradicate the GDP

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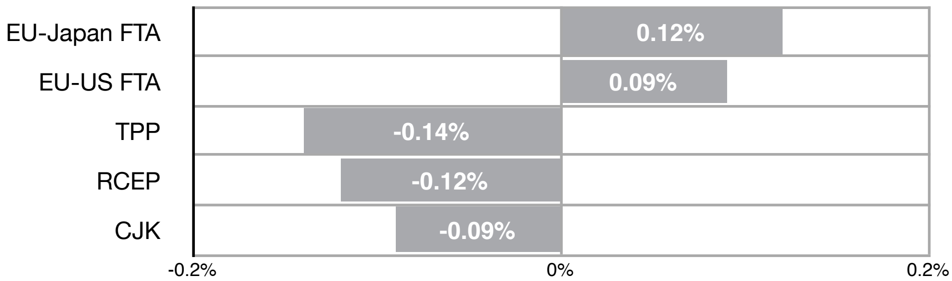
[10] Boeing has three times more Japanese suppliers than Airbus and claims to have provided 22,000 local jobs according to Boeing Japan, August 2012, http://www.boeing.com/aboutus/international/docs/backgrounders/japanbackgrounder.pdf

[11] IMF World Economic Outlook, April 2012

[12] The original TPP signatories (the so-called P4) consisting of Chile, New Zealand, Singapore and Brunei who already have FTAs with the candidates such as Japan, Vietnam, Australia, Peru and others; The US has signed FTAs with the original P4, Australia, Peru, but not yet with Japan.

gains from any 'big FTA' that the EU is willing to negotiate at this point, including FTAs with the US or Japan[13]

Table 4: Effects on EU GDP (%) from FTAs and RTAs in the Asia-Pacific



Source: Kawasaki, 2012

While it is true that the econometric methodologies involved in estimating GDP impact or trade diversion are sometimes called into question, most *a priori* impact studies are likely to be underestimates, given that they do not fully take into account the dynamic effects on competitiveness, especially when two large economies of similar structures liberalise. In this context, the main observation is how the gains and losses from different FTAs and RTAs relates to each other in size, regardless if they are all underestimates.

The impact from regionalisation is already being felt as it is already taking place on a firm-to-firm level – with or without further policy induced liberalisation. The US (despite its relative lead over the EU) has already halved its market share in Japan, and there are strong purely economic incentives for the TPP in their bilateral relationship. It is true that the TPP is not the first – nor the last – trade agreement without the EU taking part. For example, the creation of NAFTA in 1994 did not amount to any serious diversion of trade – our trade with Canada, Mexico and the US kept even pace with the booming intra-NAFTA trade up to the 2001 crisis. This was largely thanks to EU outward FDI into NAFTA that quadrupled (compared to OECD countries that on an average doubled total outward FDI) during the same period.[14] This extraordinary rise was only possible thanks to the excess supply of cash in the 90s that drove transatlantic mergers, and in turn spurred intra-firm trade between the EU and the US. The EU also concluded an economic partnership agreement (EPA) with Mexico in 1997 (eventually upgraded to a full FTA). In all, these circumstances are impossible to replicate today and on the Asian markets.

This leads us back to where we started – the EU already begins with a comparative disadvantage, while the TPP or any of the other agreements could offset gains the EU has reaped from its bilateral FTAs, opening negotiations with both Japan and the US is in first instance about preserving the *status quo.*

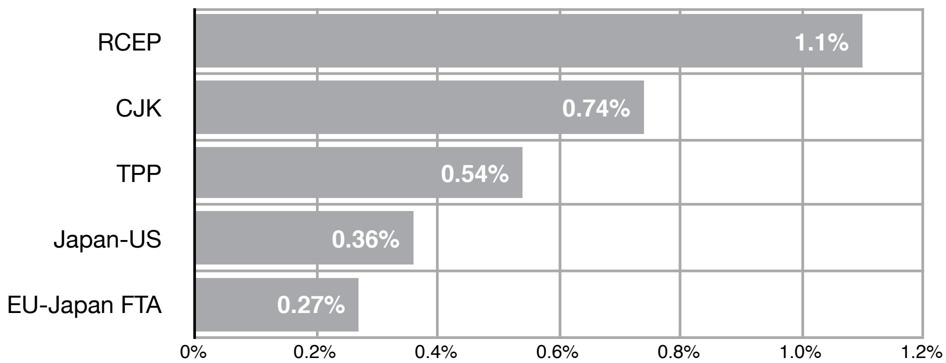
[13] Kawasaki, Determining Priority Among EPAs: Which trading partner has the greatest economic impact?, RIETI Column 218, May 31, 2011, Research Institute of Economy, Trade and Industry (RIETI)

[14] UNCTAD Statistics, 2011

4. A mismatch of priorities between the EU, the US and Japan

Japan finds itself at the centre of all variable geometries with alternative routes – the question is not only if, but who Japan will eventually open up to. While Japan has been the *demandeur* of a nEU-Japan FTA, it is clear that the EU is competing with some bigger fish in the Pacific Ocean. Japan, as a major developed economy, works from different priorities than our previous FTA counterparts. Contrary to popular belief, Japan is the least trade dependent amongst all EU FTA partners to date, with a trade-to-GDP ratio of 29% – which is half the global average, and the lowest in the Asia-Pacific along with the US.[15] Thanks to extremely liquid domestic capital markets, neither Japan nor the US are driven by demand for more FDI from the EU. In the case of Japan, GDP share of inward FDI has been near zero for more than three decades and the rationale for trade liberalisation is the need for structural reforms and revitalising the economy, which sets it apart from all the EU's previous FTA partners. In this regard, the TPP – and not an FTA with the EU – is inarguably the most defining question of Japan's trade policy as it is expected to deliver a GDP growth that is twice the level achieved from an EU-Japan FTA. However, Japan is yet to show its hand on when or if it will actually join the TPP talks despite numerous speculations and rumours regarding its timing – as the public support for entering TPP talks has swayed and practically reached critical mass, it is largely a question of *when* rather than *if* Japan will join, and a question of *by whom,* as the election date is now set for mid-December.

Table 5: Effects on Japan GDP (%) from FTAs and RTAs in the Asia-Pacific



Source: Kawasaki, 2012

The economic impact from the TPP is also likely to be higher if it lives up to its promises. The much-advertised '21st century high quality standards' in the agreement are yet to be defined by the TPP negotiators (except that the EU will fail to live up to them). Since the TPP is based on existing FTAs, all tariffs peaks and tariff rate quotas (TRQs) are expected to be phased out while the talks will delve into more complex issues, such as harmonising the rules of origin that would have considerable gains beyond mere cutting already low tariffs and seriously consolidate intra-TPP supply chains and create trade diversion. Furthermore, the negotiations will be based on a negative list on services, incorporating ambitious commitments on e-commerce (such as data localisation) and 'business mobility' (mode 4 for those who turn left when they board a

[15] World Bank, World Development Indicators, 2011. Trade as the sum of exports and imports of goods and services measured as a share of GDP. Equivalent figure for e.g. Korea is 101%; Singapore, 391%; Canada, 61%; and Peru, 51%

Boeing 787). The US is also keen to include disciplines on labour, competition and state-owned enterprises (SOEs), which are so far relatively untried concepts in bilateral FTAs and could present obstacles to certain participants.

As stipulated, the TPP (together with the plurilateral agreement on services) also is the first priority for the US. However, the inclusion of Japan changes the very nature of the TPP as it is the only candidate country without an existing FTA with the US. The competition from Japanese car brands is also a sensitivity for the current US administration while Japan would be a net importer of agricultural commodities amongst a group of major exporters. However, Washington DC seems to consider Japan to be is in a different class amongst the TPP candidates given its importance as a strategic gateway into the region. A TPP without Japan may deliver some of its strategic imperatives vis-à-vis China but will not provide the same scale of market access benefits. As the US is prone to maximise its preference gap to the competition, one cannot entirely exclude a separate bilateral FTA between the US and Japan in a case where Japan fails to present a bid to join the TPP talks.[16]

5. The ability to engage China

Despite the scale of the TPP, it is still overshadowed by a preferential agreement with its neighbours Korea and China. The CJK agreement is expected to be relatively light compared to the TPP but still have a greater GDP impact to Japan than the TPP, and potentially three times the impact from an FTA with the EU. China has occupied the top spot amongst Korea and Japan's trading partners since the mid-2000s – and these two countries have therefore no interest in 'containing' China, or have at least concluded that such a strategy is infeasible.

The Chinese and Japanese negotiators were about to engage in a scoping exercise, with both sides using Korea as a willing leverage and accomplice against the other, before that came into a hiatus over the territorial dispute. The decision on the November 20th to resume the negotiations proved three points. First, the question was resolved in a manner consistent with Chinese diplomacy towards its neighbours following major incidents where embargoes and sanctions are turned off before they cause any irreparable harm. The ongoing succession in Beijing prolonged the détente, as nationalist sentiments could be turned into a social upheaval against China's governing structure, but trade agreements tend to be a part of the solution rather than a casualty of geopolitical disputes in the Far-East.

Second, circumstances seem to suggest that China's economic liberalisation is likely to move away from slow gradualism and recapture some of the momentum under Jiang as his heirs have taken over the helms: It is the first-ever Standing Committee of the Politburo dominated by economists (rather than engineers), and the internal pressure for economic reforms is said to be fierce. However, China will not open up for foreign trade on a wholesale basis but through preferential agreements that mitigate trade diversion from other FTA/RTAs. In this regard, Beijing reads the map exactly the same way as Washington DC, but from left to right. At this point, only China's trade with Japan and Korea has the grade of sophistication and scale to balance the domestic economy or create value-added, especially on services investments that are needed to boost employment. This leads also to a third and the last point, namely that CJK is a downpayment by China and Japan for the RCEP agreement (ASEAN+6) that was announced simultaneously at the East Asia Summit.

In sum, Japan's trade strategy will look first to East and West – this meaning China and the US – while seeking to maintain a core of consistency between the two flanks. At the same time, China and the US both aim for RTAs that include Japan as their first priorities. This has a bearing on sequencing, i.e. the order concessions will be given. When an economy seeks regulatory convergence, it will seek to harmonise its rules with the largest potential market first, as it would give them the best chance to reap the reciprocal benefits. Thereafter giving away trade opening they have already made in the first deal to other 'smaller' deals, using trade

[16] Any administration in Tokyo must first back out of an election pledge by DPJ in 2009 to not to pursue a FTA with the US.

diversion from the first deal as a leverage. Japan, the US, and to some extent China, have no reason to deviate from their roadmaps as long as they remain committed to same priorities. It is the EU that reads the map in a vastly different manner, and from afar.

6. Strategic issue-linkages and the Euro crisis

So far, the Commission and the Trade Policy Committee have been privileged to conduct its work relatively undisturbed from other policy areas. EU trade policy is distinctively different from traditional national governments where trade is often subordinated to foreign policy and seldom designed in isolation. Increasing market competition between countries has made economic growth an inseparable part of foreign relations, and the current US administration publicly admits that it is following the emerging economies by putting economics 'back at the heart of their foreign policies'.[17] Such notions have limited implications for Japan's trade policy, despite its security co-operation with the US that is defining the entire region – Japan's position as a partner *supra omnes* in the Asia-Pacific theatre has merely provided the freedom to pursue FTAs and RTAs delinked from any security policy considerations, in particular with regards to China.

Meanwhile, the EU has so far failed to project its economic powers into any influence outside of its own vicinity. Most Asian governments would not consider the EU to be a strategic actor in Asia as it lacks credible objectives and resources, while a partnership with Place Schuman is often unreciprocated or sometimes technically infeasible. The actual reach of the EU's soft powers is thus far limited, and history is not short of examples where Europe's ambitions to export its values have backfired. Europe's ability to promote non-discriminatory principles and international standards while curbing mercantilism is particularly dependent on its ability to conclude FTAs with regional economic leaders, whose policies the emerging countries aspire to follow. Falling into mercantilist behaviour by engaging in free trade only when it benefits Europe reflects a stance of "do as we say and not as we do" that undermines European credibility and the longterm interests of the EU.

The commercial attractiveness of the Single Market – or principles of market liberalisation and integration – has always been the mainstay of Europe's geopolitical power. This soft power can only be projected through trade agreements. This reality is unlikely to change in the coming years, although the crisis along with growth and opportunities elsewhere have seriously undermined the leverage Europe used to wield, while it must also bargain for more complex political and economic objectives. In particular, the sovereign debt crisis has brought in new levels of interdependency: Japan and China are the world's largest holders of strategic currency reserves who have committed a minuscule amount of funds directly or indirectly to restore confidence in the Euro. It is simply not in their interest to expose themselves to such risks, without any obvious obligations or rewards for doing so. Moreover, Japan is also the second largest shareholder of the IMF, the lender of last resort for the Euro zone governments that will scrutinise the conditions of the Eurozone bailouts. In practice, the political future of some Eurozone governments could be depending on the IMF shareholders.

7. A mandate for coming large-scale FTAs

The Brussels debate has so far missed the mark when it comes to seeing the importance of the 'big FTAs' against the backdrop of Europe's ailing trade leadership. Defensive interests have been allowed to dictate the terms and define what 'free trade' should entail. The debate on the FTAs with Japan and the US has focused on the extent we can abstain from reforming our own

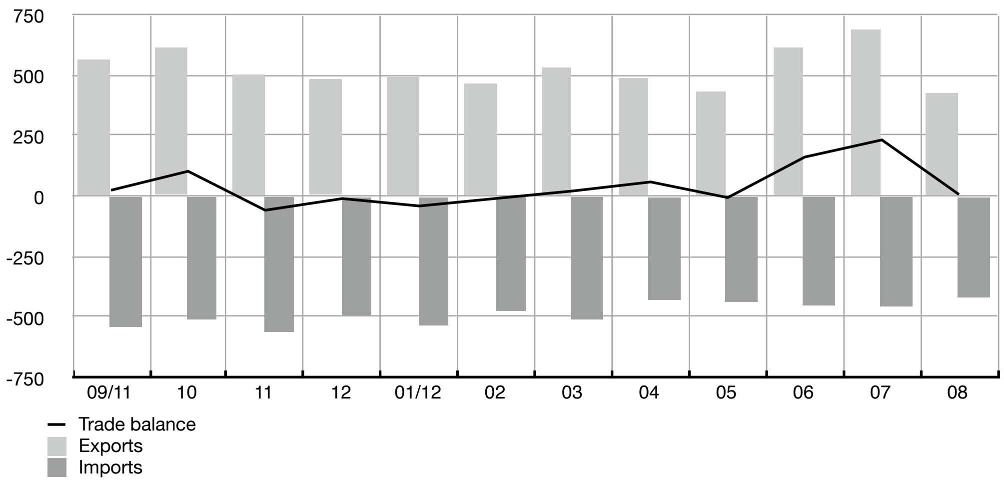
[17] Secretary of State Clinton, Address to the Economic Club of New York, October 14, 2011

sensitive sectors while exporting EU standards and regulations to our counterparts. To date, not a single piece of EU legislation has been redrafted as a result of an FTA. Neither has the EU allowed any of its services sectors to be opened up in a preferential agreement. While it is true that the EU has primarily negotiated with smaller countries or economies with inconsistent regulatory quality, this current practice of one-sided regulatory harmonisation would significantly limit the gains of an FTA with major economies with similar, non-discriminatory and WTO consistent regulatory regimes. This is particularly the case with Japan who is respondent to only fifteen WTO disputes (compared to 72 cases against the EC/EU, and 199 against the US). However, FTAs and achieving preferential access via regulatory harmonisation have little to do with WTO compliance. Two issues are critical to whether the new FTAs will be successfully concluded.

The first issue is a sense of priority amongst the NTBs being raised. The scoping exercise conducted with Japan outlined many of these issues that European exporters face, but failed to establish whether they actually bring preferential market access. For example, there is insufficient priority given to services, although the lack of competitiveness for EU manufacturing comes from the limited ability to compete on distribution, retailing, financing and maintenance. Attention is more often paid to NTBs that are politically difficult to tackle yet bring little or no market access. For example, getting rid of the non-discriminatory tax discounts on ultra-light cars (so-called *kei* cars, which are mostly cheap vans and delivery trucks) would not increase sales of stylish and expensive French and Italian small cars that are clearly unfit for that purpose.[18] However, it would open the floodgates for counterclaims against various tax breaks in the EU, including tax rebates on diesel that benefits EU manufacturers. Some of NTBs are not raised with market access in mind, but with the intention to weakening the EU's ability to conclude the FTA – and a strict application of parallelism leads directly into that trap.

The second issue is how these regulatory divergences will be addressed. To take one example, the standards on whole car type approval under FMVSS (the North American standards) or JASIC (Japanese standards that dominates Asia) are unlikely to be abandoned by our counterparts while they are even recognised as equivalents by the de facto EU standard setting body (UN Economic Commission for Europe, or UNECE). Instead, mutual recognition between the standards of high quality regulatory regimes is the most effective market access tool, and entirely removing the foreign regulator from the import process was also the very basic principle of the Single Market.

Table 5: EU trade surplus with Japan on passenger cars (last 12 months; million €)



Source: Eurostat, 2012

[18] European small cars are retailed in Japan at 90% above European prices. See Lee-Makiyama, FTAs and the crisis in the European car industry, ECIPE Policy Brief 02/2012

As the examples illustrates, the car market has replaced agriculture as the most sensitive sector of the EU despite a majority of European car manufacturers are filing record profits thanks to overseas growth. The European car industry has the biggest trade surplus of all sectors, as the EU exports 3.5 euros for every euro it imports.[19] Unknown to most policymakers, the EU is also running a large surplus on passenger cars against Japan of almost half a billion Euros per year.

As the EU is increasingly asking for protection and market access at the same time, the credibility of the EU is undermined and it is increasingly branded as mercantilist. Our counterparts are carefully reading the Commission's ability to rein in the disparate (and some outright protectionist) tendencies amongst the Member States, and the far-reaching safety nets that are required. Procedural novelties such as review clauses that enable the Member States to end the talks are most likely to become permanent fixtures in EU FTA negotiations. These developments are likely to lower the level of market access that the EU will be offered: If our counterparts doubt the EU negotiators will remain seated by the negotiation table, they are less inclined to accept our demands that are sensitive to their interests. Trade negotiations are also costly and resource consuming. While smaller economies with nothing to lose will always be very keen to negotiate preferential access to the Single market, but those who have other options will chose the path of least resistance. This is why the lack of negotiation flexibility and the unprecedented specificity of the mandate is actually weakening the EU negotiation position, rather than strengthening it.

While the other trading powers observe the EU Member States and their lack of confidence in Japan to deliver concessions, they also see their lack of confidence in free trade and the Common Commercial Policy to represent its national interests.

5. Conclusion: A rite of passage towards trade-driven growth

The grades for the EU trade policy is barely *seize sur vingt* – the EU has ambitiously caught up with the US bilaterals but largely failed when it tries to go beyond them, for example in the negotiations with India or Mercosur. Unlike the 1990s when the EU was fuelled by its own internal liberalisation, it has failed to exercise a global leadership on trade in the past decade. This is perhaps most evident in the failure to take the initiative for a services plurilateral despite being the world's largest services exporter.

Despite the fact that imports has a weak or non-existent causal link to productivity and employment, and 36 million jobs are created in the EU thanks to external trade,[20] the same unease about free trade is reflected in the EU's approach to 'big FTAs' – they are necessary to deliver growth and sustain industrial capacities in recession, yet they require the EU to step out of its 'comfort zone' and her habit of receiving concessions without making any major concessions. The EU has some legitimate offensive interests towards the US and Japan, but they cannot be negotiated unless negotiations are opened. If the car industry, which has a trade surpluses with Japan, is allowed to block the FTAs, the EU is adapting to the mercantilist ideology it sets out to suppress while legitimising similar behaviour against the EU from others.

As to date, Japan is taking part in at least two out of three regional agreements (CJK, RCEP and TPP). There is now a real cost of failure if the EU does not engage in meaningful negotiations with Japan and the US in parallel. Each one of the regional agreements creates a trade diversion large enough to erase the productivity gains of the EU-US FTA, and third countries could wipe out our market presence and political influence in Japan. Furthermore,

[19] ibid.

[20] See note 3

the EU will lose any leverage against the US who will be leveraging on the TPP. Brussels may not recognise the importance of Asia, but our counterparts do. Unless the negotiations are not opened in parallel with Japan and the US, the EU may have to make do with whatever the US and Japan have already offered each other in the future TPP talks. In a worst case scenario, the EU may find itself unable to set the agenda and stuck between the ISA and the EU-US FTA, forced to open itself up on 'take it or leave it' terms.

In this regard, trade policy is not different from other disciplines of foreign policy – it is played like a game of chess, where each move changes the strategy of the other players and must be carefully planned ahead. Such thinking has so far had little bearing on EU trade policy. Instead, it has been driven by opportunism and swiftness like in checkers – a game that is played on chessboards, but fundamentally a different game. The question is whether the Member States are now ready to give a mandate to win that game.

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